

THE STREAMLINED SALES TAX PROJECT:
KEEPING ONLINE SALES FROM STAYING OFFSHORE

As we know, the Education Trust Fund is heavily dependent on revenue raised by sales taxes.

In past years, Alabama has seen significant fluctuations in the amount of revenue realized from these excise taxes. One of the culprits in the revenue decline is the skyrocketing growth in Internet sales of goods previously purchased at retail stores across the state. Most of these online purchases generate no sales tax, a fact that deprived the States of some \$19 billion last year, or more than of half of their collective budget shortfall. The States' revenue drain is ballooning, and is expected to reach \$26 billion in 2003 and \$35 billion in 2004. These are staggering and unacceptable losses.

Alabama's online sales tax shortfall in 2001 was \$177 million and is projected to reach \$604 million in 2006 unless something is done to close this elephant sized tax loophole. A solution to this problem is long overdue, and hopefully is within sight. A permanent cure is being pursued at both the State and Federal level through the work of multistate task forces and several different groups here in Alabama.

As more and more retail sales move online, a "virtual offshore" beyond the tax man's reach has been created. Besides adding to the plight of Alabama's coffers, it creates unfair competition by

Internet retailers, called e-tailers. To underscore this point, and to pressure pure Internet companies to collect the sales tax due the states, the online units of large brick-and-mortar retailers like Target, Walmart, Toys R Us and Mervyns, have voluntarily collected sales taxes on their online transactions. These businesses have courageously acted in an ethical manner by putting tax fairness ahead of the bottom line, and they are to be commended. More importantly, we should thank and sponsor these stores, and demand that their competitors likewise pay a fair tax burden.

Why doesn't Alabama collect these hundreds of millions in lost sales taxes from online, offshore e-tailers now? The Supreme Court of the United States prohibits it. In 1992, the Court ruled that the 7,500 State, county, city and local taxing jurisdictions across the Country make it too complex and burdensome for online retailers to charge and collect sales taxes. The Court ruled that, in order to collect sales taxes on e-commerce, the States must simplify their existing systems.

Currently, e-tailers find the sales taxes imposed by the local taxing authorities excessively cumbersome and difficult. Large out-of-state vendors encounter different rules, varying rates, and audits on all types of sales tax from State to State. Businesses are responsible for complying with the

sales tax rules of every jurisdiction in which they are physically located. How can the States bring online sales back onshore and tax them?

In November 2000, lawmakers from thirty-three states, including Alabama, met and took the first steps to simplify and harmonize their sales tax structures, as required by the Supreme Court. The effort was named the Streamlined Sales Tax Project.

In December 2000, the State participants in the Streamlined Sales Tax Project approved a uniform sales agreement, to be ratified by their Legislatures. Once enough states commit to the resulting uniform sales tax plan, Congressional approval would have to follow to overrule the Supreme Court. In January 2001, State Legislatures began considering the Project's uniform sales tax system. The Streamlined Sales Tax Agreement is not to become effective under its terms until at least ten states representing at least twenty percent of the population approve it. The Agreement's key tax reforms are as follows:

- A single statewide sales tax rate by 2006 for each State. Each State will be responsible for the administration of all state and local taxes and the distribution of the local taxes to all local

governments. Localities and the State will share the same tax base with no more than one sales tax per locality.

- Uniform definitions for products and services in the sales tax base. For example, we would resolve whether a marshmallow is food or candy for sales tax purposes. The State Legislatures are to establish uniform categories and definitions of items subject to tax. Among the sales tax definitions being refined are those for vending machines, food, prepared food, soft drinks, candy, medical equipment, drugs, and clothing.
- Uniform sourcing rules. The States will have uniform rules to determine which State is owed a given sales tax.
- Uniform audit procedures. The project will simplify sales tax reporting requirements for online sellers. Under the Agreement, the States will provide software free of charge to retailers that will calculate, collect and remit the taxes owed on online sales. A seller who uses this Streamlined Sales Tax system technology will either not be audited or will have a

limited audit, depending on the technology used. This will limit the taxpayer burden of multiple audits.

- Tax simplification cost savings. It is estimated that such a simplified tax system will save businesses millions of dollars in efficiencies by greatly lessening the burden of sales tax collection. State Legislatures, State Departments of Revenue and businesses have been working on this project for almost three years. Utah, South Dakota, Kentucky and West Virginia have already approved the pact. Indiana, Oklahoma, Kansas and, hopefully, Alabama are expected to follow suite this year.

To help ensure that the project will be technically fully developed upon State and Congressional approval, a pilot program to test the collection mechanisms in the new system has been in operation for over a year.

Although local government leaders in Alabama initially criticized the project's efforts to standardize the sales tax system across the state, they now seem to be satisfied with the proposal.

Due to the diligent efforts of the Alabama Department of Revenue, the Association of County

Commissioners, the Alabama Retail Association, the Business Council of Alabama, and the persistent prodding by House Speaker Seth Hammett, Alabama may soon join her sister States in implementing this much needed legislation.

The Speaker of the House has exerted a great deal of influence to move all parties to the table to find an innovative approach to allowing Alabama to participate in Streamlined Sales Tax Project. His diligence and persistence reminds the author of the large role the Speaker played in developing the 2001 Alabama Tax Reform package with the Governor and the two Houses of our Legislature. Much as in 2001, the Speaker simply would not take "no" for an answer on the Sales Tax Project. He has been leaning on the Department of Revenue to make concessions to make counties and cities as happy as possible, while also searching for a way to get Alabama under the Streamlined Sales Tax tent.

Please encourage the Legislature, the Governor, and your county and city governments, and your Congressman, to support this project, which would close Alabama education's largest tax revenue loophole.

By the end of this Summer, let us hope that the required critical mass of States approves the Streamlines Sales Tax Project. We will then look to Congress to authorize Alabama and the other States that have simplified their burdensome sales tax rules to start collecting taxes from remote online vendors.

Congress should respond expeditiously, but without betraying its obligation to promote the free flow of interstate commerce. Washington ought to listen to whatever legitimate concerns online retailers may still have, and, if necessary, impose further conditions for each State to meet before joining a compact of those allowed to collect online sales taxes. But Congress must strive to make it possible – Alabama cannot afford to see a vast swath of its retail sector transformed into a duty-free zone.